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MEMORANDUM OF CONVERSATION

Subject: Informal Discussions on the United States Standard Draft Treaty of Friendship, Commerce and Navigation

Participants: For the Ministry of Foreign Affairs:

Mr. Morio YUKAWA, Director, Economic Affairs Bureau
Mr. Kenichi OTABE, Vice Director, Economic Affairs Bureau
Mr. Haruki MORI, Chief, First Section, Economic Affairs Bureau
Mr. Masao OSATO, Chief, Fourth Section, Treaties Bureau
Mr. Takeshi KANEMATSU, Secretary, First Section Economic Affairs Bureau
Mr. Mikizo NAGAI, Chief, Sixth Section, Economic Affairs Bureau

For the Office of the United States Political Adviser, Japan:

Mr. Jules BASSIN, Legal Attache
Mr. Dudley G. SINGER, Commercial Attache
Mr. Robert W. ADAMS, Second Secretary

Place: Office of the United States Political Adviser, Tokyo, Japan.

Date: Thursday, March 13, 1952. SEVENTH INFORMAL MEETING

ARTICLE XI

Mr. Yukawa asked for clarification of the word "residents" in paragraph 3, Article XI, and for an explanation of why this word is included in this paragraph.

Mr. Bassin replied that residence is a much-used concept in United States tax law and practice, and that its presence in the treaty serves to assure to Japanese nationals all United States tax advantages and privileges to which they may be eligible by reason of their place of residence, as well as those which would accrue to them

because of their nationality. He stated that an example of this is afforded by paragraph 5 (c) of Article XI, under which Japanese nationals residing in Canada or Mexico would be entitled to the same personal exemptions as Canadian or Mexican citizens, respectively, there residing. Mr. Bassin added if the residence concept is not found in Japanese tax practice, there was no reason for omitting this concept from the treaty. He stated that the treaty would in no way require Japan to use the residence concept, but that it is needed to cover the United States.

Mr. Kanematsu stated that the residence concept is also used in Japanese tax laws. Mr. Nagai added that paragraph 3, Article XI, is intended to give most-favored-nation treatment to nationals and companies of either party with respect to the matters mentioned in paragraphs 1 and 2 of this Article. Since, by virtue of paragraph 3, most-favored-nation treatment is to be accorded to the nationals and companies of either Party, whether resident or not, the meaning of the paragraph is quite clear without the word "residents". According to most-favored-nation treatment principles, the most favorable treatment given to the nationals and companies of any third country under similar circumstances is taken as the standard. Therefore, by including in the paragraph the word "residents", which is not mentioned at the head of the sentence, the comparison of the treatment becomes ambiguous and confusing. Mr. Nagai added that there appeared to be no serious objection to the retention of the word "residents" in paragraph 3, if the American side felt strongly that it was necessary in this paragraph. He stated that he believed the paragraph would not suffer in any way, however, if the word were to be deleted. He added that the comments on this word by the American side did not suffice to answer questions which had arisen in other Government agencies or which would arise in the Diet. Mr, Nagai suggested, therefore, that the word "residents" in paragraph 3 be deleted.

Mr. Adams replied that further clarification on the use of the word "residents" in paragraph 3 would be requested of the Department of State, and, further, that Mr. Nagai's suggestion that the word be deleted would be referred to the Department of State for its comments.

Mr. Nagai added that Japan preferred that the term "non-residents" in paragraph 5 (c) be changed to "non-resident nationals", since paragraph 5 was regarded as establishing the exceptions to most-favored-nation treatment, which should, in turn, be as broad as practicable.

Mr. Bassin replied that the substitution of "non-resident nationals" for "non-residents" in paragraph 5 (c) would materially alter this reservation, one object of which is to permit a limited category of non-resident aliens to be given the same personal exemption privileges as are given non-resident nationals. He added that this category comprises aliens resident in a contiguous country, and that, in this connection, the test is the place of residence of the alien, not his nationality.

Mr. Yukawa then asked that consideration be given the revision of paragraph 5 (c) to read "to non-resident nationals and residents of contiguous countries". Mr. Otabe stated that the phrase "non-resident nationals" is used in other United States' treaties, notably with Ireland and Colombia, and that the standard draft phraseology is too wide in scope.

Mr. Otabe added that Japan would actually prefer to limit the reservation under paragraph 5 (c) to non-resident nationals, but that it was understood that such a limitation would not be acceptable to the United States. Mr. Otabe stated that it was for this reason that the Japanese side proposed the use of a phrase along the lines suggested by Mr. Yukawa, which follows the pattern employed in the United States Treaty with Ireland.

Mr. Bassin stated that the use of the phrase suggested by Mr. Yukawa in substitution of "non-resident nationals" would, if the remainder of paragraph 5 (c) were left untouched, establish a reservation entirely unlike that found in paragraph 3 (c), Article IX, of the United States' Treaty with Ireland. After pointing out the differences in phraseology between the standard draft and Irish formula, on the one hand, and the clause now proposed by the Japanese side, on the other, Mr. Bassin stated that consideration would be given the substitution of the Irish treaty clause in toto for that in the standard draft, if the Japanese side so desired.

After further study of this point, and again stressing that Japan desired to limit the reservation under paragraph 5 (c) to non-resident nationals. Mr. Yukawa proposed that the following clause (as contained in the United States' FCN Treaty with Colombia, paragraph 3 (c), Article XI) be substituted for the standard draft's paragraph 5 (c):

> "(c) accord to its own nationals and to residents of contiguous countries more favorable exemptions of a personal nature with respect to income taxes and inheritance taxes than are accorded to other non-resident persons."

Mr. Adams replied that the Japanese proposal would be transmitted to the Department of State for its consideration. He then asked if there were any points other than this question on paragraph 5 (c) which were unresolved. Mr. Yukawa stated that there were no other pending questions on Article XI and proposed that discussions continue with the next Article.

ARTICLE XII

Mr. Yukawa stated that, in the interpretation of paragraph 1, Article XII, it was his understanding that Japan need not allocate foreign currency held by the Government to an alien who, while residing in Japan, might desire to invest in his own or some third country. He added that he wished this point to be clarified since national and most-favored-nation treatment with respect to the transfer of funds between the territories of the two Parties as well as between the territories of

such other Party and of any third country") might be subject to various interpretations.

In response to a question by Mr. Singer, Mr. Yukawa stated that it was understood that aliens would be granted national and most-favored-nation treatment with respect to payments and remittances, within appropriate Japanese control regulations, as well as with respect to financial instruments, between Japan and their own or any third country. For example, he added, an American businessman would not be discriminated against in trade between Japan and Argentina, and he could make all transfers of payments in this connection on an equal footing with Japanese businessmen.

Amplifying his original question, Mr. Yukawa stated that foreign exchange held by the Government might be made available to a Japanese national who wished to invest dollars abroad (for example, in the development of natural resources in Southeast Asia). Such foreign exchange would be made available to a Japanese national when for example, the foreign investment in question would contribute to Japan's requirements for raw materials, or eventually to Japan's balance of payments position. Such foreign exchange for investment purposes could not be granted to aliens, although the latter were entitled to withdraw their earnings or dividends, subject to appropriate regulation, for whatever purposes they might desire.

Mr. Adams replied that the foreign-exchange funding mentioned by Mr. Yukawa implied a special fund set aside by the Government for investment which would contribute to Japan's economy. It was to be assumed, he added, that Japan's exchange control authorities would review investment opportunities falling under this category on a case-by-case basis, and would authorize investment only when specific conditions and standards were met by the applicant. This procedure was therefore unlike the normal foreign-exchange allocation system, which should be non-discriminatory in application, and left Japanese control authorities free to approve or disapprove investment opportunities in accordance with their established standards. Mr. Adams stated that the provisions of paragraph 1, Article XII, did not extend to aliens the right automatically to participate in such special foreign-exchange funding, but he pointed out that it was possible that an American concern domiciled in Japan could develop resources in a third country for the exclusive benefit of the Japanese economy. It was believed therefore that participation by an American firm in Japan's special foreign-exchange investment funding would be reasonable in these circumstances and would merit sympathetic consideration by Japan's exchange control authorities.

Mr. Yukawa inquired whether it was understood that neither party was more obligated under paragraph 2 of Article XII than it would be under the International Monetary Fund. Mr. Singer replied that paragraph 2 would not impose greater restrictions on Japan in this respect than were established by the International Monetary Fund.

Mr. Yukawa stated that he understood that the question of whether the level of monetary reserves were reasonably adequate was a matter to be determined by the country which enforces the exchange control, and that, until such time as free convertibility of currencies is restored, the adequacy of the level of monetary reserves was to be judged in accordance with the various currencies held by the determining country. Mr. Yukawa stated that he understood that a favorable pound sterling position would not be regarded as establishing an adequate level of monetary reserves with respect to dollars, if at the same time, Japan's dollar position were weak. Mr. Singer replied that Mr. Yukawa's understanding on these points was correct.

Mr. Yukawa then asked if his assumption was correct that Article XII generally admits the existence of differences in the manner and extent to which exchange controls may be imposed with respect to different currencies. He added that it was also understood that such measures as are, or may become, necessary under Japan's foreign exchange quarterly budget system for the utilization of inconvertible currency (e.g., higher import allocations in sterling than are possible for dollar imports, or preferential foreign exchange licensing procedures for sterling as compared with dollars) are admissible under Article XII.

Mr. Adams replied that it was understandable that Japan might wish under special circumstances to apply controls over various currencies in accordance with different standards. These standards would, in turn, depend upon Japan's balance of payments position with respect to the particular currency in question. He added that such controls should be held to the minimum consistent with the provisions of paragraph 2, but that it was realized that occasions would arise which might require a more rigid control over dollar allocations for imports than over sterling allocations. Mr. Adams expressed the opinion that such differences in control measures were admissible under the provisions of paragraph 2, and would not necessarily be regarded discriminatory if the control measures were reasonable and justifiable and were applied to the currency itself. Mr. Adams added that within this system of varying controls applicable to currencies, it was understood that there would be no discrimination or differentiation applied against United States nationals, to whom most-favored-nation treatment would be accorded.

Mr. Otabe asked whether it was understood that the country imposing the exchange control would of itself determine the amount of foreign exchange necessary for the goods and services essential to the health and welfare of its people, and, further, would decide as to what was reasonable provision for the withdrawal of compensation, earnings and investment in foreign currency.

Mr. Bassin replied that Mr. Otabe's views were correct, but pointed out that what Japan might in some cases consider "reasonable" provision for the withdrawal of earnings might not be so regarded by the United States. He pointed out that in any differences of opinion of this kind consultation in accordance with Article XII, paragraph 6, might be in order.

Mr. Otabe then asked whether it was understood that the necessity and reasonableness of exchange restrictions with respect to paragraph 4 was to be determined primarily by the country imposing the exchange controls, which would also determine whether or not these measures were detrimental or discriminatory to the interests of the nationals of the other party and the competitive position thereof.

Mr. Bassin replied that it is intended that Article XII should permit reasonable measures needed to safeguard a country's balance-of-payments position. He stated that a primary purpose of the Article is to provide that such measures be formulated and applied in a justifiable and orderly manner. He added that it was understood that Japan would determine what exchange restrictions it would impose. With respect to the question as to whether these restrictions might be detrimental or discriminatory to United States nationals, Mr. Bassin pointed out that this was a matter of direct and understandable concern to the United States in properly safeguarding the interests of its nationals.

Mr. Bassin further stated that this Article is not framed in a manner to afford reservations to the particular rules of non-discrimination which are set forth in Article XIV regarding the import-export trade. Any reservations to the latter, which may be necessary to allow relief to a country in present or prospective balance-of-payments difficulties, is found in Article XXI, paragraph 3, of the standard draft. The latter clause in Article XXI allows a country, and would so allow Japan upon its adherence to the GATT, to maintain its rights under the GATT, of which perhaps the most important is the right to impose discriminatory import-export restrictions on balance-of-payments grounds.

Mr. Otabe stated that Japanese Government establishes a schedule of foreign exchange convertibility for the withdrawal of earnings from Japan for each type of investment activity and service contracts in Japan. He inquired whether it was understood that, in accordance with continued Japanese legislation along these lines, this preferential system of withdrawal of earnings for certain types of investments was permitted under Article XII.

Mr. Singer replied that he understood that Japanese regulations permit foreign exchange remittances up a certain maximum percentage of the Japanese yen earnings for a foreign company or branch in Japan (e.g. foreign shipping companies are allowed to convert into foreign currency for remittance abroad up to 20 percent of their Japanese yen receipts for freight exchanges). Mr. Singer stated that he also understood that this maximum percentage varied from one particular type of business activity to another, so that a firm operating in one field of activity might be allowed to remit 90 percent of its yen earnings, while a firm in some other field of activity would be limited to 30 percent of its

yen earnings. Having been informed by the Japanese representatives that this understanding was correct, Mr. Singer stated that the existence of these varying percentage standards for remittances were admissible under Article XII, provided there was no discrimination in the application of these standards, and that all firms and individuals engaged in a particular field of activity were given equal opportunity for the conversion of their yen earnings for remittance purposes.

Mr. Singer further stated that it was understood that these varying percentage standards, having been established by appropriate regulation under law, would be known to a foreign national or firm upon registration to do business in Japan. Such standards, he added, might be subsequently reduced in exceptional circumstances if Japan's balance of payments position so demanded, pursuant to the principles of Article XII, but it was understood that such action would not be taken in an unjustifiable manner, nor would it be applied retroactively to affect accumulated earnings which were subject to - but not yet converted under - a higher percentage standard for transfer of dividends or earnings. Mr. Nagai replied that if it were found necessary to reduce such a percentage standard, the new standard would apply from the date of its announcement, and would not affect earnings awaiting conversion under the previous standard of remittance convertibility.

Mr. Adams stated that it must also be understood that foreign-exchange controls would not be utilized to restrict convertibility beyond the legally established percentage standards. For example, he added, it would be considered unjustifiable and discriminatory if foreign exchange convertibility were withheld from a certain field of activity (already entitled to a certain percentage standard of remittance), while extending convertibility to firms engaged in some other field of activity. Mr. Otabe replied that this understanding was correct.

Mr. Yukawa stated that the second sentence of paragraph 3 concerning several exchange rates seemed unnecessary, because upon participation in the International Monetary Fund, Japan would comply with the provisions of paragraph 3, Article VIII, of the IMF which prohibits a country from engaging in any discriminatory currency arrangements, except as authorized under the IMF Agreement or specifically approved by the IMF.

Mr. Singer pointed out that Japan might, at some future date, have different rates of exchange for remittances and foreign trade payments, although it might retain the present dollar-yen ratio as its official rate of exchange. Mr. Singer added that various countries now have two or more official or semi-official rates of foreign exchange, and that it was not improbable that such a situation might at some time prevail in Japan, thus necessitating a provision such as that in paragraph 3.

Mr. Yukawa replied that this matter would be referred once more to the Ministry of Finance for its consideration.

Mr. Yukawa stated that paragraph 6, Article XII should be deleted because its substance is covered by Article XXIV of the standard draft.

He added that this provision applies to all articles in the treaty and that its inclusion in Article XII is misleading, giving the impression that "consultation" may have greater reference to Article XII than to any other Article in the Treaty.

Mr. Singer replied that this paragraph was included in Article XII for psychological reasons, since this Article is of direct concern to investors and businessmen who would wish to see in this Article every justifiable safeguard of their interests. Mr. Singer stated that he believed that the Department of State would be reluctant to consider the deletion of paragraph 6, in view of the many questions which would be raised by the business community in the United States.

Mr. Yukawa stated that it was his understanding that paragraph 6, Article XII, does not require consultation prior to Japan's taking any measures consistent with this Article.

Mr. Bassin replied that much understanding was correct, pointing out that Japan and the United States do not now consult in advance concerning Japan's foreign exchange regulations. He stated that the United States might request consultation after the fact if some control action were found to be unduly discriminatory to American interests, but that consultation before the fact was not required under paragraph 6.

Mr. Yukawa replied that this point would also be referred to the Ministry of Finance for its study and consideration.

It was then agreed that the next meeting would take place on Monday, March 17, 1952.

/s/ M. Yukawa

Morio Yukawa
Director
Economic Affairs Bureau
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/s/ Frank A. Waring

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